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July 10, 1981

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER PORTER TREASURY

SUBJECT: Current Situation in Poland

Attached for your information are three tabs describing the present economic situation in Poland (Tab A), its external financial squeeze (Tab B), and a Polish economic recovery scenario (Tab C).

Polish Request for Assistance

On July 2, 1981, Polish Ambassador Spasowski formally presented to Agriculture Secretary Block, the Government of Poland's (GOP) latest request for economic assistance. The request was for 400,000 M.T. of corn, valued at about $80 million, to increase Polish poultry output quickly this summer. This request follows recent GOP appeals for assistance in drawing down the remaining $113 million in CCC guarantees, out of the $670 million provided them in FY 81.

Poland's External Financing Needs in 1981

1. Much of Poland's foreign financing need in 1981 of $11.3 billion has been met by Western creditor groups through rescheduling, credits already granted, or freezing of principal repayments on private bank credits. Financing of $8.9 billion has already been arranged, although all of it has not yet been utilized, especially lines of credit with Western European governments. The U.S., with $600 million, is the single largest contributor of official credits so far this year.

2. The remaining financing gap is in the range of $2.4 billion. Given the already sizable U.S. contribution this year, particularly in view of our relatively smaller financial and economic ties with Poland, the U.S. position has been that the remaining gap should be filled by the Europeans and Soviets.

3. Neither the Europeans nor the Soviets have shown much enthusiasm for further credits. European performance on credits this year has been particularly disappointing. The major European participants in Polish creditor

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meetings have pledged slightly less than $1.2 billion. Only some $300 million of this total has actually been drawn this year. At the last creditor meeting on Poland June 1-2, France was the only country to offer further credits -- and this offer only amounted to $60 million. We estimate that U.S.S.R. and other CEMA countries provided $700 million in the first quarter of 1981, but hard figures are not available. The Poles claim CEMA has decided against providing further hard currency assistance in 1981

4. Our latest information on reponses to the Delors proposal to the 16 creditor countries that they cooperate through the BIS to provide short-term credit facilities to the Poles is that only the Swiss have come forward, with an offer of $50 million. France proposes to offer $100 million.

Table 1: POLAND'S FINANCING GAP IN 1981

	(billions)
Current Account Deficit	$3.0
Amortization	7.5
Credits Extended	0.2
Short-Term Capital Flight	0.6
Gross Financing Needs	$11.3
Sources of Financing	
Already in Place	
Official Rescheduling (Paris Group)	$2.9
Western Export Credits	0.7
Socialist Assistance (First Quarter)	0.7
Western Financial Credits (First Quarter)	0.2
Subtotal	$4.5
Expected	
Official Rescheduling (Other Western)	$0.6
Private Rescheduling	2.4
Undrawn European Export Credits	1.4
Subtotal	$4.4
Financing Gap	$2.4

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Options for USG Assistance to Poland

In the event that the USG may decide to reverse its current position that new financing to Poland will not be provided, a series of possibilities (of varying merit and ease of implementation) exists. They are reviewed below.

1. USG Loan Guarantees

   A. The Export-Import Bank could provide additional guarantees. The Bank's financial guarantee assures repayment of private bank credits used to finance the U.S. content of capital equipment exports and large scale installations. It is frequently used in parallel to Eximbank direct lending. The Bank also has guarantee programs for short and medium term bank and commercial credit. Poland is now cutting back on investment, especially that requiring imported goods, and new tied export credits for capital goods imports could be counter-productive for Polish economic recovery. The USG normally does not provide commercial guarantees which we know will have to be rescheduled.

   B. The Commodity Credit Corporation could provide additional guarantees for U.S. agricultural commodities under its GSM-102 (all risk) program. This program is currently insuring 100 percent of principal and 6 percentage points of interest. The underlying loans financing the agricultural exports are for three years at market rates. These relatively short maturities run a real risk of further complicating Poland's debt problems in the next few years. The provision of additional guarantees would also further compromise this commercial market development program. Over one-third of CCC's portfolio is now in Poland and any new guarantees will have to be rescheduled.

   C. There are no other USG guarantee programs available.

2. USG Direct Loans

   A. The Export-Import Bank's direct loan program is used to achieve the same end as the Financial Guarantee programs, and the problems of extending it are similar.

   B. Commodity Credit Corporation GSM-5 loans. This is a short term (three year repayment period) direct

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credit program with interest rates equal to the cost of money to the corporation. This program is presently not funded and would require OMB approval to become operative. The program does not require appropriations unless there is a default.

C. Commodity Credit Corporation GSM-301 loans. This is a commercial program of direct credits with a 3 to 10 year repayment period and interest rates equal to the cost of money to the corportation. The program was established in 1980 but never funded. The local currency receipts the purchasing government obtains when it sells the commodity obtained from this program to its people must be used for projects to facilitate imports. The projects must be agreed to before the loan is approved.

D. Exchange Stabilization Fund. The Secretary of the Treasury has broad discretion over use of the ESF, subject to approval of the President. Use of the ESF for Poland in present circumstances, however, would pose major problems and risks for the ESF and the Secretary's continued authority over the ESF -- in terms of legislative requirements and Congressional intent respecting the ESF, consistency with past practice, precedent for other countries, and the ESF's financial position.

E. Federal Reserve. The Fed has established a number of criteria for extension of swap credit -- e.g., IMF membership, IMF "convertible currency" status, assurance of repayment in the short-term -- none of which apply in the Polish case. A Fed waiver of those criteria in the Polish case would raise serious problems of precedent for the Fed and could draw questions about proper exercise of the Fed's authority to "open or maintain accounts in foreign countries." Those criteria aside, the Fed has also resisted operations that would appear to rely heavily on political factors, and would probably insist on parallel ESF participation and an ESF take-out in the event of non-repayment of a Fed swap.

3. Economic Assistance

A. Section 620 (F) of the Foreign Assistance Act probihits the USG from providing assistance to Communist countries unless the President finds and reports to Congress that (1) such assistance

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is vital to the security of the U.S., (2) the recipient is not controlled by the international Communist conspiracy and (3) the aid would promote the recipient's independence from it.

B. PL 480 (Title 1) limits food aid commodities to be allocated to countries not meeting the IDA criteria for poverty to no more than 25 percent of the total provided in each fiscal year. There is a legislative constraint on providing this kind of assistance to Communist countries comparable to that in the Foreign Assistance Act.

4. New Legislation

This approach would take time and have additional budgetary costs, but it would allow the fashioning of virtually any sort of program deemed beneficial to the Polish economy.

Possible Multilateral Assistance

1. IMF Financing. Poland is not an IMF member and cannot draw on IMF resources. It is not clear at this point whether Poland is seriously interested in IMF membership or could obtain the acquiesence of the Soviet Union in applying for membership. There are also questions about Poland's willingness to meet the obligations of IMF membership -- e.g., regarding the provision of economic information to the IMF. If Poland were to apply, negotiations on membership and completion of voting requirements, quota subscriptions, etc., normally take several months to complete. Moreover, it is not clear whether or when Poland would develop an economic program sufficient to justify use of IMF resources.

2. IBRD. Poland would have to join the IMF before they could join the IBRD. In any event it would take time to develop the necessary projects eligible for IBRD financing even if Poland were to join immediately. Poland, moreover, is not a less-developed country.

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